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7 WORLD SURVEILLANCE GROUP INC.,  
8 Plaintiff,  
9 v.  
10 LA JOLLA COVE INVESTORS, INC.,  
11 Defendant.

Case No. [13-cv-03455-JD](#)

**ORDER GRANTING MOTION TO  
DISMISS**

Re: Dkt. No. 39

12  
13 **INTRODUCTION**

14 This case arises out of alleged breaches of investment agreements between plaintiff World  
15 Surveillance Group Inc. (“WSGI”) and defendant La Jolla Cove Investors, Inc. (“La Jolla”). In a  
16 prior round of pleadings challenges, the Court dismissed without prejudice WSGI’s claims for  
17 intentional misrepresentation, fraud in the inducement, and securities fraud for failure to satisfy  
18 the heightened pleading requirements of Federal Rule of Civil Procedure 9(b), and also dismissed  
19 without prejudice WSGI’s claim for breach of fiduciary duty. Dkt. No. 36. WSGI amended its  
20 complaint to try to save these claims but the amendments are not enough. They are now dismissed  
21 with prejudice. WSGI’s claims for breach of contract, breach of the covenant of good faith and  
22 fair dealing, and under the California Unfair Competition Law will go forward.

23 **DISCUSSION**

24 **I. Breach of Fiduciary Duty**

25 The Court’s prior dismissal order outlines the factual background and the pertinent legal  
26 standard, which will not be repeated here. *See* Dkt. No. 36.

27 The Court’s prior order dismissed WSGI’s breach of fiduciary duty claim because it failed  
28 to allege facts sufficient to show that, in this arms-length business deal, La Jolla assumed the

1 mantle of a fiduciary for WSGI and intended to act primarily for WSGI's benefit. Dkt. No. 36 at  
2 4. The amended complaint again fails to plead facts indicating that the relationship between  
3 WSGI and La Jolla was anything other than a garden-variety contract with no special duties or  
4 obligations attendant to it.

5 The governing California state law on this issue is straightforward. A fiduciary  
6 relationship is a special circumstance in which the fiduciary "assumes duties beyond those of mere  
7 fairness and honesty" and "must undertake to act on behalf of the beneficiary, giving priority to  
8 the best interest of the beneficiary." *Comm. On Children's Television, Inc. v. Gen. Foods Corp.*,  
9 35 Cal.3d 197, 222 (1983). "A fiduciary's power to transact business with his beneficiary is  
10 severely limited; he must use the utmost good faith and, if he profits from the transaction, the law  
11 presumes the agreement was entered into by the beneficiary without sufficient consideration and  
12 under undue influence." *Id.* (internal quotations omitted). The obligation to put the interests of  
13 the other party first is why a fiduciary relationship generally does not arise out of ordinary arms-  
14 length business dealings. In a typical business contract or relationship, one party does not commit  
15 to act in the other party's best interest rather than in its own. *See, e.g., Scognamillo v. Credit*  
16 *Suisse First Boston LLC*, No. C-03-2061 TEH, 2005 WL 2045807, at \*4 (N.D. Cal. Aug. 25,  
17 2005) (finding no fiduciary relationship because it was "highly unlikely that the CEO and CFO of  
18 a company on the other side of a merger deal would seek to act in the target company's best  
19 interests"). This is why a fiduciary relationship will be found only when an individual or entity  
20 has knowingly undertaken that high duty or when the law imposes the duty in special relationships  
21 such as agency, partnership or joint venture. *City of Hope Nat. Med. Center v. Genentech, Inc.*, 43  
22 Cal. 4th 375, 386 (2008); *Comm. On Children's Television*, 35 Cal.3d at 222. Consequently, to  
23 state a claim for breach of fiduciary duty, WSGI must allege that La Jolla either knowingly agreed  
24 to act on behalf and for the benefit of WSGI, or that it entered into a relationship with WSGI that  
25 imposed that undertaking as a matter of law. *See City of Hope*, 43 Cal.4th at 386.

26 WSGI did not meet this requirement. In the wake of the prior dismissal, the amended  
27 complaint added three allegations intended to show a fiduciary relationship: (1) "it was WSGI's  
28 understanding that La Jolla would, in addition to, and separate from, any financial agreement

1 between the parties, use its expertise as investors as well as its business knowledge to take the role  
2 of fiduciaries in advising and supporting WSGI during the growth of its business, acting primarily  
3 in and for WSGI's benefit" (Dkt. No. 38 at 5); (2) La Jolla "made specific statements about how  
4 La Jolla was acting, and would continue to act, in the best interest of WSGI and its shareholders"  
5 (*id.* at 11); and (3) "[p]ursuant to the statements and assurances made by La Jolla . . . and WSGI's  
6 understanding of its relationship with La Jolla, La Jolla established, either through their explicit or  
7 implicit representations, a fiduciary relationship with WSGI, which included explicit or implicit  
8 fiduciary duties to WSGI to act on, and/or for the benefit of WSGI" (*id.* at 48).

9 These conclusory allegations do not come close to alleging facts sufficient to impose the  
10 exceptional duties of a fiduciary on La Jolla. Taken as a whole, the transactions described in the  
11 amended complaint -- and in the deal documents WSGI attached to it (Dkt. No. 38, Exs. A, B, and  
12 C) -- were typical arms-length business dealings between an investment house and a company  
13 looking to raise money. The amended complaint offers no facts whatsoever showing that La Jolla  
14 knowingly undertook the duty of putting WSGI's interests before its own and acting as WSGI's  
15 fiduciary. The allegation that "it was WSGI's understanding" that La Jolla was acting primarily in  
16 and for its benefit may describe WSGI's hopes and dreams but it does not demonstrate that La  
17 Jolla consciously committed to assuming that role. And the amended complaint does not allege  
18 any facts to support the allegation that La Jolla represented that it would "use its expertise as  
19 investors as well as its business knowledge to take the role of fiduciaries in advising and  
20 supporting WSGI during the growth of its business." Dkt. No. 38 at 5. Nor does the amended  
21 complaint allege anything supporting the existence of a relationship such as joint venture or  
22 agency that would impose the duty as a matter of law.

23 Because WSGI has failed to adequately allege the fiduciary duty claim after two  
24 opportunities, it is dismissed with prejudice.

## 25 **II. Intentional Misrepresentation and Fraud In the Inducement**

26 As the prior dismissal order held, WSGI's claims for intentional misrepresentation and  
27 fraud in the inducement are subject to the heightened pleading requirements of Federal Rule of  
28 Civil Procedure 9(b). The Court dismissed these claims for failure to state the "time, place, and

1 specific content of the false representations as well as the identities of the parties to the  
2 misrepresentation.” Dkt. No. 36 at 4-5.

3 WSGI responded by adding 22 new allegations in the amended complaint. *See* Dkt. No.  
4 38 at 4, 11-12, 20-21, 51-52, 54. But most of these additions again fail to state the time, place,  
5 specific content of the representations and identities of the parties to the misrepresentation, (*see,*  
6 *e.g.*, Dkt. No. 38 at 4, 51-52, 54-55 (alleging only that sometime in 2011 and 2012, La Jolla made  
7 “certain assurances” to WSGI through agents of the companies “including but not limited to”  
8 Messrs. Estrella and Huff, and that “from the beginning of the relationship with La Jolla, La Jolla  
9 fraudulently induced WSGI, through their factual omissions, to sign the Agreements”)), or they  
10 are actionable puffery, (*see, e.g.*, Dkt. No. 38 at 11, 12, 20 (Mr. Huff’s statement that La Jolla  
11 was dedicated to being the “perfect [paraphrasing] financial partner,” and that he “expressed La  
12 Jolla’s committed desire to support the stock price in any way it could,” and Mr. Sanberg’s  
13 statements about La Jolla’s “continued support of and commitment to WSGI’s well-being,” and  
14 “how excited La Jolla was to be associated with WSGI”). *See In re iPass, Inc. Sec. Litig.*, No. C  
15 05-0228 MHP, 2006 WL 496046, at \*4 (N.D. Cal. Feb. 28, 2006) (describing puffery as  
16 “statements consist[ing] of forward-looking or generalized statements of optimism that are not  
17 capable of objective verification, and lack a standard against which a reasonable investor could  
18 expect them to be pegged.”) (internal quotations omitted).

19 The few allegations that get by the “who, what, when, where, and how” requirement of  
20 Rule 9(b) fail to state fraud claims because they were made well after the parties had executed the  
21 contracts. WSGI alleges that on the evening of June 28, 2012 -- approximately five months after  
22 the investment agreements were executed in January 2012 -- Mr. Huff told Glenn Estrella, an  
23 executive officer for WSGI, at Incanto restaurant in San Francisco that “La Jolla would continue  
24 to provide WSGI with capital to fully fund the ongoing operations of WSGI while sponsoring  
25 WSGI’s further research and development as well as its marketing initiatives.” Dkt. No. 38 at 11.  
26 WSGI alleges similar representations at another in-person meeting between the parties in August  
27 2012. *Id.* at 20-21.

1       These statements do nothing to support WSGI's fraud claims because the ink was already  
2 dry on the deal documents by the time they were allegedly made, and consequently WSGI could  
3 not have relied upon them as a basis for entering into the contracts or relationship. *See*  
4 *Manderville v. PCG & S Group, Inc.*, 146 Cal.App.4th 1486, 1498, 55 Cal.Rptr.3d 59, 69 (2007)  
5 (intentional misrepresentation claim requires plaintiff to allege and prove that he or she actually  
6 relied upon the misrepresentations and, in the absence of the misrepresentation, would not have  
7 entered into the contract); *Julius Castle Restaurant Inc. v. Payne*, 216 Cal.App.4th 1423, 1442,  
8 157 Cal.Rptr.3d 839, 853 (2013) (fraud in the inducement claim requires reasonable reliance on  
9 assurances made prior to entering into an agreement). These claims are also dismissed with  
10 prejudice.

11 **III. Securities Fraud**

12       Securities fraud claims must satisfy the heightened pleading standards of both Rule 9(b)  
13 and the Private Securities Litigation Reform Act ("PSLRA"), 15 U.S.C. § 78u-4. *See In re*  
14 *VeriFone Holdings, Inc. Sec. Litig.*, 704 F.3d 694, 701 (9th Cir. 2012). The PSLRA requires a  
15 plaintiff alleging securities fraud to "plead with particularity both falsity and scienter." *Zucco*  
16 *Partners, LLC v. Digimarc Corp.*, 552 F.3d 981, 990-91 (9th Cir. 2009).

17       The Court's prior order dismissed WSGI's securities claim because the complaint failed to  
18 allege scheme liability under § 10(b) of the Securities Exchange Act and Rule 10b-5, and also  
19 failed to adequately allege scienter. *See* Dkt. No. 36 at 6-7, 8 n.5. Under Rule 10b-5, a defendant  
20 who uses a "device, scheme, or artifice to defraud," or who engages in "any act, practice, or course  
21 of business which operates or would operate as a fraud or deceit," may be liable for securities  
22 fraud. 17 C.F.R. § 240.10b-5; *WPP Luxembourg Gamma Three Sarl v. Spot Runner, Inc.*, 655  
23 F.3d 1039, 1057 (9th Cir. 2011).

24       As an initial matter, the Court has serious doubts that La Jolla's alleged conduct falls  
25 within the scope of § 10(b) liability. In *Stoneridge Inv. Partners v. Scientific-Atlanta*, the Supreme  
26 Court considered an allegation of scheme liability under § 10(b) where there was no duty to  
27 disclose, the alleged deceptive acts were not communicated to the public, and no member of the  
28 investing public had knowledge, either actual or presumed, of the alleged deceptive acts. *See*

1       *Stoneridge Inv. Partners v. Scientific-Atlanta*, 552 U.S. 148, 160, 128 S.Ct. 761, 169 L.Ed.2d 627  
2       (2008). The Court found that alleged scheme liability failed because a private cause of action  
3       under § 10(b) was not meant to be applied beyond the securities markets to cover “all commercial  
4       transactions that are fraudulent and affect the price of a security in some attenuated way.” *See id.*  
5       at 161; *Sec. Exch. Comm’n. v. Zandford*, 535 U.S. 813, 820, 122 S.Ct. 1899, 153 L.Ed.2d 1 (2002)  
6       (“[Section 10(b)] must not be construed so broadly as to convert every common-law fraud that  
7       happens to involve securities into a violation”); *Marine Bank v. Weaver*, 455 U.S. 551, 556, 102  
8       S.Ct. 1220, 71 L.Ed.2d 409 (1982) (“Congress, in enacting the securities laws, did not intend to  
9       provide a broad federal remedy for all fraud.”). WSGI has not provided the Court any authority  
10      showing that La Jolla’s alleged conduct falls within the confines of a § 10(b) claim, and the Court  
11      is reluctant to extend § 10(b) liability to allegations that amount merely to a breach of contract  
12      claim. *See Foster v. Wilson*, 504 F.3d 1046, 1051 (9th Cir. 2007) (finding that “at most” the  
13      plaintiff’s claim alleged a breach of contract, and concluding that “[s]uch a breach, however, does  
14      not constitute federal securities fraud under § 10(b.”)).

15           Even if § 10(b) liability were proper, the additional factual allegations in the amended  
16      complaint do not salvage this claim. The alleged fraudulent scheme is that La Jolla bought  
17      WSGI’s shares at a deep discount and short sold those shares “to manipulate the stock prices to  
18      their advantage.” Dkt. No. 38 at 57. Short selling stock, however, requires that the seller borrow  
19      shares for a certain period of time and then return them. *See United States v. Deeb*, 175 F.3d  
20      1163, 1165 n.4 (9th Cir. 1999) (explaining that in a “short sale, an investor contacts his broker and  
21      borrows a particular stock from the broker and sells it on the open market. The investor receives  
22      the proceeds from the sale and then has a certain amount of time within which to return the  
23      borrowed stock to the broker.”) The amended complaint neither alleges that La Jolla borrowed  
24      stock from WSGI and subsequently returned it, nor provides any specific details about how La  
25      Jolla allegedly manipulated WSGI’s stock price, aside from the details about La Jolla’s history of  
26      funding under the Agreements. Moreover, the allegations added to the amended complaint to  
27      support WSGI’s claims for fraudulent inducement and intentional misrepresentation do not bolster  
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1 its § 10(b) claim, because they do not pertain to the alleged scheme to sell WSGI's shares at a  
2 deep discount or through short sales.

3 In addition, the amended complaint does not allege a proper inference of scienter on the  
4 part of La Jolla. Post-PSLRA, a plaintiff must allege with particularity facts giving rise to a strong  
5 inference that the defendant acted with the required state of mind. *See* 15 U.S.C. § 78u-4(b)(2).  
6 At minimum, a plaintiff must plead particular facts giving rise to a strong inference of deliberate  
7 or conscious recklessness. *See No. 84 Employer-Teamster Joint Council Pension Trust Fund v.*  
8 *America West Holding Corp.*, 320 F.3d 920, 937 (9th Cir. 2003). Even considering the complaint  
9 as a whole, WSGI has failed to plead the existence of a strong inference that anyone at La Jolla  
10 acted with deliberate or conscious recklessness in allegedly purchasing and selling WSGI's shares.  
11 The Court dismisses this cause of action with prejudice, as WSGI has had two opportunities to  
12 plead this claim.

### 13 CONCLUSION

14 WSGI's claims for breach of fiduciary duty, intentional misrepresentation, fraud in the  
15 inducement and securities fraud are dismissed with prejudice. WSGI's other claims for breach of  
16 contract, breach of covenant of good faith and fair dealing, open book account, account stated and  
17 UCL violation will go forward.

### 18 IT IS SO ORDERED.

19 Dated: September 2, 2014



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20 JAMES DONATO  
21 United States District Judge

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